NATIONAL TAX ASSOCIATION

REPORT OF THE COMMITTEE ON THE FEDERAL INCOME TAX

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Your Committee has been guided in its deliberations by the hope of aiding in a constructive reform of the income-tax law. We have not entered into the general question of the desirability of the retention of the income tax as a part of our revenue system. There seems to be no demand throughout the country for a repeal of the law. There is, however, a general dissatisfaction with its complexity and strong objection to several of its provisions which are contrary to the principles of just taxation, work unnecessary hardship and result in unfair discrimination between various classes of taxpayers.

The Committee has therefore devoted most of its attention to the problem of simplifying the law and suggesting such changes as will tend to make it operate more equitably. There are, however, some general considerations that should be borne in mind when any comprehensive alterations of the law are undertaken. We shall, therefore, relegate to the conclusion some of these general considerations, reserving our specific recommendations for the report proper.

Before, however, we present our specific recommendations, your Committee would like to call particular attention to the need of correcting the many verbal infelicities of the present law.

It is recognized that the construction of the act by the rulings of the Treasury Department has tended to clarify many of its ambiguous and obscure passages. On the other hand, your Committee believes that such construction has operated to the detriment of the taxpayers in several instances, notably that with regard to the deduction of losses incurred in trade.

While the Committee does not question the propriety of any rulings that have been made, it desires to call attention to the fact that the trouble is frequently to be ascribed to the lack of clearness in the law itself. The language of the law is

in need of great improvement. The lack of system in the arrangement of subsections and paragraphs, the long and involved sentences and the frequent introduction of provisos make the act most difficult to understand. Your Committee desires to express its earnest hope that especial attention will be paid to this point. The recasting of the language of the law should be undertaken by experts qualified to deal with so intricate and complex a task. No congressional committee working under pressure of other matters, and with the limited time at its disposal, can be expected to draft and to work out satisfactorily the minute details of arrangement of an act such as this. And it would be of little avail for your Committee to undertake the task. Our first and most important general recommendation therefore is in favor of a complete restatement and clarification of the law.

We now come to the specific recommendations as to points in which not only the language but the subject-matter of the act itself is in our opinion in need of alteration. We give first a list of these recommendations and then proceed to explain them.

Recommendations.

I

That part of the act which requires the collection of the tax at the source should be modified.

II

A system of information at the source should be introduced.

III

Partnerships should be required to file substantially the same kind of returns as corporations are required to file and to pay the normal tax as corporations do.

IV

Individuals should be permitted to deduct all losses, including a reasonable allowance for depreciation incurred in the business, trade or profession in which they are engaged, and including also losses of property used for investment or spec-

ulative purposes where the gain, if any, would be subject to tax.

V

Expenses incurred by individuals in making investments and managing property, with respect to which the income is taxed, should be permitted as are expenses of carrying on business.

VI

Allowances for the depreciation of property and for the depletion of natural resources should be on a basis which will permit the return of the capital invested therein, free from tax, as nearly as possible coincident with the obsolescence of the property or the exhaustion of the resources.

VII

Individuals should be permitted to deduct taxes paid within the year in foreign countries upon the property or business from which the taxable income was derived.

VIII

The specific exemption should be lowered and the language of paragraph "C" should be clarified.

IX

Individuals having a gross income equal to, or exceeding, the minimum exemption should be required to make returns.

X

Taxpayers keeping books of account in accordance with statutory requirements or well recognized methods should be permitted to make their returns based thereon.

XI

Every corporation should be permitted to deduct all amounts received by it within the year as dividends upon the stock of other corporations, joint-stock companies or associations, subject to the income tax.

XII

The parent and its subsidiary corporations should be recognized as a single entity for purposes of the return in cases where they constitute a single operating system or where in determining net income for their own purposes no recognition in accounting is made of the subsidiary companies as distinct operating units and in all cases where all the stock of the subsidiary company is owned by the parent company, a consolidation of figures should be allowed in appropriate cases subject to the approval of the department.

XIII

Taxpayers should be permitted, with the approval of the Commissioner of Internal Revenue, to adopt the practice of determining and reporting gains or losses by annual inventory of values.

XIV

Application for refund of income taxes with consequent right of appeal from the decision of the department should be allowed not only as at present within two years from date of payment of the tax but also, as a matter of course, at any time, without limit, as an offset where additional tax for any year is claimed by the Government.

XV

The permission now granted to officials of States levying an income tax to inspect the returns of corporations should be extended to the returns of individuals.

XVI

The Act should define some, at least, of the special terms therein contained.

XVII

Provision should be made for a more elaborate publication and analysis of income-tax statistics.

We now proceed to give our reasons for these recommendations.

I. That Part of the Act Which Requires the Collection of the Tax at the Source Should be Modified.

It is morally wrong that the Government should force corporations and individuals who by accident of circumstance have control over the payment to others of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments or other fixed or determinable annual gains, profits and income, to perform the work of collection which properly belongs to the Government and to bear without compensation a great part of the expense of collecting the tax.

It might be claimed that this objection can be removed by the government agreeing to reimburse the original taxpayers for their outlay. It would, however, be exceedingly cumbersome for the government to make such an arrangement and there would be grave danger of abuse. Moreover, even if such an arrangement was made, the objection would be only in part removed. For the real difficulty with the scheme is the excessive cost of collection, whether this cost be defrayed by the government or by the taxpayer.

It is true that since the law first went into operation, there has been, as might be expected, some reduction in the cost of collecting the tax; but it is still excessive. Your Committee has instituted a careful inquiry into this matter and finds the facts to be as follows:

A group of financial institutions who act as paying agents or fiscal agents for corporations report that the cost of collecting the tax ranges from 10 per cent to 20 per cent of the amount turned over to the government. The variation is doubtless due partly to the fact that where bonds are tax-exempt the work of handling certificates is much less than where the corporation does not assume the tax, and certificates have to be handled with the greatest care. If most of the bond issues on which a trust company pays interest are tax-exempt, the cost is naturally lower than in the other case. That the maximum figure of 20 per cent is not excessive for many companies is very certain. With one large company the Committee has been able to go over the details of the calculation, and finds that the additional clerical assistance occasioned by

the law has been from $5,000 to $7,000, and that the total tax collected has been $35,000 per annum. This figure of the cost does not take into account incidental items other than clerk hire, or include overhead charges.

A number of small banks and trust companies which do not act as paying agents report an insignificant amount of tax collected and an insignificant cost of collection. The law has occasioned them some trouble, and much of it unnecessary; but they are unable to estimate the expense, and say that neither the expense nor the tax is of any importance.

From a number of corporations, railroads, other public service companies, and manufacturing corporations, the Committee has received data showing the cost of collection ranging from 1 per cent to 70 per cent. The figure of 1 per cent was given by a large corporation, the bonds of which are tax-free; but it is exclusive of any additional cost imposed upon fiscal agents. At the other end of the scale is another corporation, none of whose issues are tax-free, which reports the cost of collection in excess of 70 per cent. It pays its coupons over the counter; and this figure probably shows the whole cost of collection, since there is no paying agent.

Most of the data secured by the Committee show costs of collection running from 10 per cent to 20 per cent, whether they are obtained from banks or from debtor corporations. These figures are confirmed by other evidence. We are informed that since the income tax went into operation, paying agents have very generally increased their charge for paying coupons from one-eighth of one per cent to one-fourth of one per cent, and corporations have accepted such increase as reasonable.

If we assume that this increased compensation of one-eighth of one per cent represents the additional cost which the law occasions to the paying agent plus a reasonable profit, we see that the average cost to paying agents is one-eighth of the normal tax of one per cent less whatever allowance may be made for profit. If, however, a large number of the bonds are held by persons with incomes of less than $3,000, the tax will not equal one per cent of the interest paid, and therefore the figure of one-eighth of one per cent may mean very much

more than one-eighth of the amount of tax received by the government. In general, we can safely say that the cost of collecting the tax on bond interest ranges from 10 per cent to 20 per cent, and in a large number of cases is nearer the larger than the smaller figure.

The excessive cost of collection is not the only objection to the system of collection at the source. Among the other shortcomings are the following:

Collection of the tax at the source enriches the Government wrongfully at the expense of corporations indebted upon coupon or registered bonds. Where the corporation has assumed and agreed to pay the tax directed by the Act to be withheld, compliance with the statute requires it to pay the tax in cases where the bondholder, although entitled to an exemption, fails or refuses to file a claim to exemption. The debtor corporation has no means of either compelling the bondholder to claim such exemption or of ascertaining whether or not in fact he is entitled thereto. Its only course is to pay to the Government an amount equivalent to one per cent of the amount of interest paid to the bondholder. The amount so paid may or may not be a tax justly due the Government. Frequently it is not. Naturally, it is impossible to gather figures to indicate the amount which is so paid not as a tax but as a penalty. The corporation is penalized for the carelessness or perverseness of its bondholders. It is not an answer to say that the corporations should never have entered into these contracts. The contracts have served a useful purpose in relation to state laws where the bondholder is taxed and the corporation through its treasurer is required to deduct and to collect the tax. The assumption of the tax by the corporation has served to make the investment more attractive and has no doubt reacted upon the interest rate. Such contracts are now in no small measure a necessity in bond issues intended for wide distribution. The investor insists upon the covenant in some jurisdictions.

Collection at the source in its relation to so-called "tax-free" covenants results in an unjust discrimination between bondholders under the same mortgage. Collection at the source is required only on payment of interest to individuals.

Corporations and partnerships must by the terms of the act be paid in full without deduction for the tax. The debtor, therefore, under an agreement with all of its bondholders intended to operate to the benefit of all alike, and accepted with that understanding by the investors, is compelled by the terms of the act to pay the tax for those of its bondholders who are individuals but not for corporations or partnerships. Either the debtor corporation should be required to assume the burden of the tax for all of its bondholders—or, as this committee contends, the burden should be placed where it properly belongs, that is, on the recipient of the income.

Where an individual is an investor in the "tax-free" bonds of two or more corporations, and his aggregate income therefrom exceeds three thousand dollars, if single, or four thousand dollars if married and living with his wife, he may for no particular reason, throw the burden of the tax upon any one of the corporations by deliberately refusing to claim a fair proportion of his exemption against the interest he receives from it. He is enabled by the terms of the Act to work injury to his debtor, and the debtor has no remedy for the wrong. If he receives income from such bonds and also from other sources, the Act permits and tacitly encourages him to throw the burden of the tax on the corporation which pays him "tax-free" interest and to claim all of his exemption against other income from sources which do not protect him by "tax-free" covenants. As a result he enjoys a greater exemption from the tax than that to which he is entitled.

There is no attempt on the part of your Committee to advocate on behalf of debtor corporations a release to any extent from the responsibilities which they should lawfully assume under the provisions of the covenants here discussed; but it does contend that the Act should not enforce a partial and discriminatory execution of such contracts, nor should it so pervert the operation of the contracts as to cause the corporation to be unjustly burdened with the payment of moneys which do not represent the tax, or which represent the payment of more than a just proportion of the bondholder's tax.

The covenants in terms specify that the corporations will pay for the bondholder any *tax* which it is required to with-

hold and deduct from interest payments. Where the bondholder is subject to no tax the corporation should pay no amount to the Government. Where the bondholder has other income the corporation should in all justice be entitled to the benefit of a just proportion of the bondholder's exemption, for the tax is not on his entire income, but only on that amount over and above the exemption. Neither is the tax imposed on all income from certain sources leaving other income against which to claim exemptions. No such distinction between different kinds of income is intended by the Act, yet the necessary result of the provisions for collection at the source is to make that distinction.

The so-called tax-exempt covenant was in reality never intended to operate under a personal income tax. The civil war income tax acts contained a provision that certain specified classes of corporations should be subject to pay a tax of five per centum of the amount of all their interest or coupon payments to whomsoever payable, with a proviso that said companies were authorized to deduct and withhold from all such payments the amount of the tax. The payment of the tax so deducted discharged the company from liability for a corresponding amount of interest upon the obligations referred to, except where the company might have contracted otherwise. This tax was held by the Supreme Court of the United States in Railroad Company *v.* Collector, 100 U. S. 595, and in United States *v.* Erie Railway Company, 106 U. S. 327, to be, not an income tax upon the holders of the corporate obligations affected, but an excise tax upon the business of the corporation in respect to its interest payments, the company being merely granted the privilege of passing this tax on to the holders of its securities.

The so-called "tax-free" clause in modern corporate obligations arose from these provisions of the civil war income tax acts. It was designed to protect the creditor against the passing on to him of this type of tax. In other words, he took advantage of the suggestion in the law itself to demand contracts protecting him against the deduction of this kind of tax. The language of the typical "tax-free" clause, how-

ever, framed at the instance of creditors who demanded protection against every possible contingency in the premises, is, in its usual form, so broad as apparently to comprehend not only an excise tax upon the business of the corporation deductible as against its security-holders, but a tax like the present income tax which is levied, not upon the corporation, but upon the recipient of the interest, and which solely, as a means of collection, the corporation is required to withhold and pay to the government. The corporations and their creditors have accepted this construction of these clauses under the present act. The result has been that a tax which Congress intended to levy upon the income-receiver has, in this case, been shifted to the income-producer. It thus falls not upon the "swollen fortune" which it is the professed purpose of this act particularly to reach, but primarily upon the corporation and, in some cases, finally upon the unfortunate "ultimate consumer" who was supposed already to be more than sufficiently taxed.

The recipient of income subject to deduction of the tax at the source is deprived of the use and benefit of the money withheld during the period of time between the date of withholding and the date on which by the terms of the Act the tax becomes due. He receives no evidence of the payment of the tax on which he can rely for defence in the event of proceedings instituted against him by the Bureau of Internal Revenue. The danger is not fanciful. Tenants are withholding agents and it is not inconceivable that a tenant may be insolvent or have disappeared when the time for payment arrives.

As opposed to these shortcomings of the system of collection at source, the chief argument advanced in its favor is that it insures the accuracy of the return and provides a control on the statements of individuals. Your Committee does not desire to express any opinion on the question as to whether such a control is necessary, nor does it desire to compare the system of collection at source, as practiced in England and the United States with the system of individual return as found in the German income taxes. On the assumption, however, that such a control is desirable, your Committee would

like to point out that the same purpose may be achieved by a system which is to a large extent free from the objections that attach to collection at source. This system, which has been called that of information at source, will be fully explained in the next recommendation, and would in the opinion of your Committee constitute a considerable improvement over the existing method.

While the Committee believes that a proper system of information at the source will furnish all the safeguards needed to prevent evasion, it recognizes that there is one class of incomes with reference to which Congress may desire to retain the principle of collection at the source, namely, incomes received by American citizens residing in other countries and by non-resident aliens to the extent to which they are taxable under the act. If it should be desired to continue to collect the normal tax from these incomes at the source, it would be possible to make a provision by which this should be done. It might, for instance, be enacted that the normal tax of one per cent be withheld and deducted from fixed and determinable incomes of whatever amount received by, or accruing to, citizens of the United States residing abroad and taxable non-resident aliens, proper administrative provision being made in connection with the general scheme of information at source hereinafter developed to establish the taxable status of the recipient of such income.

II. A System of Information at the Source Should be Introduced.

Under the present system of collection at the source the Bureau of Internal Revenue has no means of accurately checking the returns of taxpayers except by assembling the multitude of ownership certificates, arranging them under the names of the respective signers and adding up the total of income reported and exemptions claimed by each. Unless this be done the Bureau must rely not only on the honesty of the taxpayer but on his intelligence and care as well. Many persons signing ownership certificates keep no record of the exemptions theretofore claimed on other certificates during

the year, and many are uncertain as to the effect of claiming exemption on the certificates and others are careless and unsystematic. Undoubtedly excessive claims for exemption are frequently made with no intent to defraud the Government. The complicated arrangement of the annual return of individuals makes it not unlikely that amounts of income on which exemption was claimed are often placed in column A, resulting in a further possible loss to the Government.

The only means of guarding against the potential losses referred to in the preceding paragraph lie in the diligence with which the Bureau of Internal Revenue collects and assembles the ownership certificates.

After the collection and indexing of the certificates has been completed it is of little practical importance whether the amounts thereon stated represent merely income from various sources or income from which the tax has been deducted. In either case the Government has the same definite information concerning the income of the taxpayer and the same power to enforce payment of the tax. If the ownership certificates indicate the taxable liability of the signer, why should not the Government proceed by direct means to collect the tax from the taxpayer instead of using the present indirect means which place additional expense upon certain classes of citizens and result in unfair discrimination?

Your Committee recommends a system of information at the source which will require the recipient of income to give the payer once each year, or at the time of payment, a receipt in such form as may be prescribed by the Treasury Department. Such receipts should be forwarded by the payer to the local collector as ownership certificates now are. The payer should be required to make oath that he has obtained and filed receipts for all payments of income of the kinds enumerated in the Act. Penalties should be prescribed for attempts to evade the law or the obligations placed by it upon payers and recipients of income. Your Committee further urges that a reasonable compensation be paid to the payer of income, based upon the number of receipts filed with the Government, to compensate him for the expense incurred.

A practical working-out of this system would result in re-

ceipts used by individuals and corporations, receiving many payments in the course of the year, having the name of the recipient printed thereon primarily for the convenience of the Government in aiding it to decipher signatures. The signature on the receipt being merely for the purpose of authentication, the printed names only need be consulted in assembling the certificates.

To put our suggestions more in detail, your Committee recommends that all persons, firms, corporations, *etc.*, who pay to any other person subject to taxation under the act amounts of fixed and determinable income, other than interest upon bonds and other obligations of corporations, joint-stock companies and associations, in excess of the amount of $800 per annum, shall, on or before the first day of March in every calendar year, report to the Collector of Internal Revenue of the district in which they reside the amount of all such income paid.

In the case of interest paid upon bonds or other obligations of corporations, joint-stock companies or associations, information can be secured of all payments by requiring the corporation or its fiscal agent to report, on or before the first day of March in each calendar year, the amount of such payments whether they exceed $800 or not.

To provide for the case of coupon bonds, it should then be provided that no corporation or its fiscal agent should pay any interest coupon unless it is accompanied by a certificate containing the name of the owner; and then providing that no person, company, or corporation shall buy or accept for collection or deposit any such coupon without requiring the holder to file a certificate stating that he is the owner, and giving his address. The person, company, or corporation buying or accepting for deposit should be required to certify to the signature of the signer of the certificate, but not, of course, to the fact of ownership of the bond. Under this arrangement no person could cash or deposit a coupon without filing a certificate stating that he was the owner of the bond, and the person buying the coupon or taking it for collection would have to certify to the identity of the person who claimed to own the bond. The corporation or its fiscal agent would in

this way be provided with evidence about the ownership of coupon bonds, and could by a card index keep track of bond holders. The government would obtain its information once a year in convenient form, and after the first year changes in ownership only would need to be noted.

Under this plan of information at the source, no questions need ever arise as to whether a person was liable to tax or entitled to exemptions or abatements, because the person paying the income could in all cases file his certificate and let the government deal with the question of liability. Since no money is to be withheld and deducted and accounted for, the problem will be enormously simplified.

The objection is sometimes made that to collect the tax from the bondholder will impair the obligation of contracts made between corporations and their bondholders. The Committee attaches no weight to this objection. As is pointed out above, the so-called tax-exempt covenant was never intended to operate under a law taxing personal income as such. But entirely apart from this consideration, it must be remembered that no one claims that it is a violation of the contract to collect from the bondholder the additional tax, which may amount to six per cent, and that the law does this without any question. How then can it be claimed that it is a violation of contract to collect the normal tax from the bondholder?

III. Partnerships Should be Required to File Substantially the Same Kind of Returns as Corporations are Required to File and to Pay the Normal Tax as Corporations do.

The partnership, as such, is not taxable but may be required by the Commissioner of Internal Revenue to file returns of net income for the purpose of determining the tax liability of the partners.

Your Committee believes that the law should be amended so that partnerships should file substantially the same kind of report as corporations are required to file and pay the normal tax as corporations do.

In this case, however, it would be necessary to add a pro-

viso that partnerships must also disclose in their return of net income, for the purpose of the additional tax, the names of all partners and their respective interests in the income of the partnership, whether distributed or not.

IV. Individuals Should be Permitted to Deduct all Losses Including a Reasonable Allowance for Depreciation Incurred in the Business, Trade of Profession in which They are Engaged and all Losses of Property Used for Investment of Speculative Purposes where the Gain, if any, would be Subject to Tax.

The fourth deduction allowed to individuals reads as follows:

"Fourth, losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise."

The second deduction allowed to corporations reads as follows:

"(Second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any."

The distinction in the phraseology is probably due, in part at least, to the fact that the individual cannot be permitted to deduct "all losses actually sustained with a year", because there are many losses connected with his domestic or personal life which it is probably desirable to exclude, such as loss of jewelry, automobiles used strictly for pleasure, *etc.* But in so far as business enterprise is concerned, the distinction in the phraseology is open to criticism.

It is immaterial from a practical point of view whether the owner of a given business is an individual or a corporation. The same deductions should be allowed to each. No reason has occurred to the Committee why an individual should be allowed to deduct losses arising from fires, storms or shipwreck and not from floods and other calamities. The English law permits the deduction of any loss connected with or aris-

ing out of the trade. Whether or not that rule be adopted, deductions for losses should be uniformly allowed to all business enterprises, regardless of the fact that the business may be conducted by corporations or by individuals.

The law permits the deductions by individuals of losses "incurred in trade." The Treasury Department holds this to mean losses incurred in the business of the taxpayer and to preclude the deduction of losses on isolated investments.

On the other hand, gains from isolated investments are taxed.

Perhaps no provision of the law has met with more objection than this. Your Committee urges that the law be changed to permit the deduction of losses with respect to any transaction where the gains are taxed.

Much argument could be made on the proposition that increase in capital assets is not income in the true sense of the word, but for the purpose of the tax it works substantial justice to tax gains on transactions involving exchange of capital assets. To be consistent and just, however, the converse must be recognized and losses should be permitted to offset gains. The injustice of a provision which calls for a ruling such as the following is apparent:

LOSSES IN TRADE: "A person not a recognized or licensed dealer in stock and bonds makes $5,000 profit during the year on a stock purchase and sale, and makes a loss during the same year on a stock purchase and sale of $4,000. Is it correct to return this difference of $1,000 in gains, or should the entire $5,000 be returned as gain?"

This office holds that the profit of $5,000 is income to be included in a return of income, and that the $4,000 is not such a loss as may be deducted in a return of income, for the reason that it is not incurred "in trade" within the accepted definition of that term. (T. D. 2135.)

Your Committee, therefore, recommends that the fourth deduction allowed to individuals should include all losses incurred in the business, trade or profession in which they are engaged and all losses of property used for investment or

speculative purposes where the gain, if any, would be subject to tax.

V. Expenses Incurred by Individuals in Making Investments and Managing Property, with Respect to Which the Income is Taxed, Should be Permitted as are Expenses of Carrying on Business.

The act allows the deduction of the necessary expenses actually paid in carrying on any business, not including personal, family, or living expenses. This leaves a doubt as to expenses incurred in managing property held for investment (insurance, commissions for collecting rents, repairs, etc.). Such management is not commonly regarded as carrying on a business; neither, however, are the expenses of management personal, family or living expenses. It would be easy to set this matter clear. Management expenses should be treated like business expenses.

VI. Allowances for the Depreciation of Property and for the Depletion of Natural Resources Should be on a Basis Which will Permit the Return of the Capital Invested Therein, Free from Tax, as nearly as Possible Coincident with the Obsolescence of the Property or the Exhaustion of the Resources.

The same rule should apply to allowances for depletion of natural resources as to depreciation. That is, the amount of capital originally expended by the corporation or individual owner in development work should be returned free from tax. The annual allowances should not be limited to 5 per cent of the gross value at the mine, but should be such reasonable amount as will in the aggregate equal the amount of capital originally expended at or as near as possible to the time when the natural resources are exhausted. If the allowance aggregates an amount equal to the amount of capital originally invested before the resources are exhausted, no further allowance should be made, as the net income thereafter will represent gain entirely. Should the natural resources diminish

more rapidly than estimated, a larger allowance should be made, permitting if necessary a claim equal to the entire net income in the year in which exhaustion occurs.

Your Committee would suggest the adoption of the Wisconsin phraseology, which has been found to be both practicable and sufficiently elastic to permit of equitable application. The Wisconsin law authorizes "in the case of mines and quarries an allowance for depletion of ores and other natural deposits on the basis of their actual original cost in cash or the equivalent of cash." *

VII. Individuals Should be Permitted to Deduct Taxes Paid within the Year in Foreign Countries upon the Property or Business from Which the Taxable Income was Derived.

The third deduction allowed to individuals is in terms as follows:

"third, all national, State, county, school, and municipal taxes paid within the year, not including those assessed against local benefits."

The fourth deduction allowed to corporations reads as follows:

"(fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country."

Your Committee is of opinion that individuals should be permitted to deduct taxes paid to foreign countries. No good reason occurs to us why the individual engaged in business should be denied the right extended to corporations.

* Mr. Kennan dissents on the ground that, as to property acquired before March 1, 1913, the basis from which profit or loss is reckoned should be the fair value of the property at the time the law went into effect and *not* the original cost.

VIII. The Specific Exemption Should be Lowered and the Language of Paragraph "C" Should be Clarified.

The tax is now imposed on about one-half of one per cent of the population of the country. It should rest on a larger proportion of the population.

The exemption of $3,000 of income to the individual citizen is undoubtedly too high; and since the government needs additional revenue, the Committee recommends that the exemption be lowered to $2,000. We recognize that the circumstances attending the enactment and first operation of the law of 1913 may have justified as high an exemption as $3,000, but we believe that those circumstances are passed, and that it is on every account desirable to reduce the exemption to $2,000.

When this is done, the provision relating to husbands and wives living together and making a joint return of their incomes should be changed so as to do away with the absurdity of the present arrangement by which a husband and wife receive a larger total exemption if they live apart. If the individual exemption is lowered to $2,000, it will be entirely practicable to grant to a husband and wife living together and making a joint report of their income a total exemption of $4,000, which would be the same exemption that they would receive if they lived apart and made individual returns, each receiving an exemption of $2,000.

The language of Paragraph C leaves to judicial construction the questions whether or not the specific exemption should be deducted from net income in assessing the additional tax; whether or not it may be deducted by non-resident aliens either *in toto* or in part according to the proportion of a non-resident alien's total income arising in this country; whether the aggregate incomes of husband and wife are to be considered as the income of the family as a unit or those having separate incomes are each entitled to a deduction of $3,000, and an additional deduction of $1,000 when living together. Before these questions are finally settled it will be necessary for the highest court to announce its opinion. This will take several years, and Congress in the meantime can and should summarily announce its intent in unmistakable language.

IX. Individuals Having a Gross Income Equal to, or Exceeding, the Minimum Exemption Should be Required to Make Returns.

The present law requires those having *net* incomes of $3,000 or over to file returns. This leaves the taxpayer to be the judge of the propriety of deductions which may reduce his net income below the minimum. The Government should be the judge of such deductions—not the taxpayer.

Your Committee is of the opinion that every individual whose gross income reaches or exceeds the limit of the minimum exemption should make a return, although the allowable deductions may reduce his net income to the point of exemption.

X. Taxpayers Keeping Books of Account in Accordance with Statutory Requirements or Well Recognized Methods Should be Permitted to Make Their Returns Based Thereon.

The Act permits to individuals the deduction of expenses *actually paid,* interest *paid within the year,* taxes *paid within the year,* and losses *actually sustained within the year;* to corporations, expenses *paid within the year,* losses *actually sustained within the year,* all sums *paid within the year for taxes.*

The law should be amended so as clearly to permit the deduction of any of the items referred to, if the individual or corporation has so entered them on the books as to constitute a liability against the assets. Furthermore, any regulations which tend to impose vexatious adjustments of books of account, where the government does not lose any revenue, are unwise and unnecessary.

For many years attempts have been made on the part of corporations and partnerships to arrive at a final figure in closing their books, which can be relied upon as the "net profit" of a year's operation. Where this amount is determined by sound business and accounting principles, and where it substantially agrees with the law and regulations, no immaterial adjustments should be required, because it means cor-

responding adjustments in subsequent years with the result that the books of account and the returns never agree.

For instance, some corporations accrue their taxes, others do not, some partnership accounts (particularly professional vocations) are kept on a "cash" basis, others, including most commercial concerns, are kept on an accrual basis.

Therefore, where a certain system of accounts has been used for a period of years, and where it honestly reflects actual profits or losses, some leeway should be left to the department to obviate the expense and annoyance of an almost complete analysis of a year's transactions.

The government would not lose by such procedure. If expenses actually accrued within a year, although not paid until afterwards, are taken credit for in the period when incurred, the most the government would ever lose would be a postponement of a year in collecting the tax, the taxable amount being the same.

The attitude of some inspectors in criticizing rates of depreciation and similar deductions is apt to work great harm from an economic point of view. Perhaps most business men are optimists and state results of a year's operations on the most favorable basis possible. Bankers and other credit grantors have worked very hard to correct this tendency, as it usually leads to business failure. Liberal reserves and provisions for depreciation and other recurring losses, should be encouraged—not discouraged.

Business men who have been forced to be conservative and not overstate their profits, take advantage of what to them appears to be official government sanction to low depreciation and other reserves. The government cannot lose any revenue by sanctioning sound accounting policies, but it can and does encourage unsound business method by criticizing conservative procedure.

Corporations keeping books according to the rules laid down by the Interstate Commerce Commission, or the public-utility commissions of the various states should not be required to make returns in a form which requires great work and expense in compiling the figures. They should be permitted to file sworn copies of their balance sheets, supplemented by

such explanation as the Treasury Department may find necessary of the items which enter into any particular account. To exact a supplementary statement, as that on the back of the return of net income of corporations for the present year, is a useless exercise of inquisitorial power. The value of the supplementary statements is no greater than that which it supplements. Neither can be checked except by an examination of the books, and the penalties for false statements are no greater because repeated in both.

XI. Every Corporation Should be Permitted to Deduct all Amounts Received by it within the Year as Dividends upon the Stock of Other Corporations, Joint-Stock Companies or Associations, Subject to the Income Tax.

That provision of the law, which taxes corporations upon dividends received from other corporations while exempting such dividend in the hands of individuals is an unjust discrimination between classes of taxpayers and is double taxation of income.

It seems to have been the deliberate intent of Congress to tax holding companies at a greater rate than other taxpayers. This is accomplished by requiring corporations to pay the tax on dividends received from other corporations. To penalize a corporation for holding stock in other corporations under lawful authority of the state in which it is incorporated is not within the proper scope of a taxing act. The ulterior motive is to be condemned. If Congress intends to discourage the holding of stock by certain corporations, suitable legislation to accomplish that purpose should be enacted after a full discussion of the questions of constitutionality and public policy involved therein.

XII. The Parent and its Subsidiary Corporations Should be Recognized as a Single Entity for Purposes of the Return in Cases where They Constitute a Single Operating System or where, in Determining Net Income for Their Own Purposes, no Recognition in Accounting is Made of the Subsidiary Companies as Distinct Operating Units; and in all Cases where all the Stock of the Subsidiary Company is Owned by the Parent Company, a Consolidation of Figures Should be Allowed in Appropriate Cases, Subject to the Approval of the Department.

At the time of the passage of the income law there existed, and still exists, a well recognized method of doing business. Railroad corporations were perhaps the first to make use of it where it was necessary for legal reasons to form separate corporations in the several states in which they desired to hold franchises. Business corporations use the method for convenience of operation, to protect trade names, to utilize good will and established reputation or for other legal and proper reasons. The method referred to is that of doing business by means of several corporations usually controlled by one known as the parent or holding company and all constituting parts or branches of a single business enterprise. The fact that this method has been used at times in attempts to restrain trade or create monopoly does not condemn it. There can be no doubt that the majority of business enterprises so conducted are law-abiding and honest. To work injustice upon all in order to punish a few is contrary to the elementary principles of law, and it may be questioned whether it is within the province of a taxing act to attempt to regulate or to suppress a particular class of taxpayers. Justice and fair dealing demand that the burden of the tax should be equitably distributed.

Transactions often take place between parent and subsidiary corporations, such as transfers of credit, sometimes incorrectly called "gifts", from the parent company to a subsidiary, to offset losses incurred by the latter. Such transfers of credit should not be treated as either income of the

subsidiary or expense of the parent company. As the law now stands, a "gift" is not deductible from the net income of the parent company but must be accounted for as income by the subsidiary. The result is a double tax on the amount involved in a transaction which is nothing more or less than a bookkeeping entry.

The law should be so framed as to tax the parent and subsidiary companies on their aggregate gross income minus their aggregate allowable deductions and to permit a combined return covering all corporations constituting a single business enterprise or system where no distinction is made by the company itself for accounting or financial purposes. This disposition of the matter would follow the practice now used by public-service corporations in reporting to the Interstate Commerce Commission. This change would not only be in the interest of fairness and equity but would go far toward simplifying the operation of the law, substituting one return where several are now filed and permitting easier inspection of the return by the government.

XIII. Taxpayers Should be Permitted, with the Approval of the Commissioner of Internal Revenue, to Adopt the Practice of Determining and Reporting Gains or Losses by Annual Inventory of Values.

In Regulations, No. 33, Article III, issued by the Treasury Department on or about January 5, 1914, provision was made that "in cases wherein there is an annual adjustment of book values of securities, real estate and like assets, and the increases and decreases in values thus indicated are taken up on the books and reflected in the profit and loss account, such readjusted values will be taken into account in making the return of annual net income. . . . The adjustment referred to will comprehend assets which have increased in value as well as those which have decreased." Article 134 also contained a ruling that depreciation in book values must represent an actual shrinkage in values which may be determined to have taken place during the year for which the return is made.

Treasury Decision 2005, dated July 8, 1914, reversed the foregoing rulings, which had been in force also under the Corporation Excise Tax Law, and held that a loss to be deductible must be an absolute loss, not "a speculative or fluctuating valuation of continuing investment, but must be an actual loss, actually sustained and ascertained during the tax year for which the deduction is sought to be made; it must be incurred in trade and be determined and ascertained upon an actual, a completed, a closed transaction."

While your Committee concedes that the Treasury Department has good authority in the federal courts for its reversal of the former ruling and for its present contention that mere changes in book values do not constitute either loss or gain until there is liquidation, yet the first construction placed upon the act greatly added to the convenience of the taxpayer in making his return of net income and resulted in substantial justice to the Government.

A merchant is permitted to make annual inventory of his stock in trade and his income is based in part on the difference between the inventories taken at the beginning and at the end of the year.

Your Committee sees no reason why the dealer in securities or in real estate or in any other species of property should not justly be permitted to determine his income as the merchant does. Nor can it conceive of any reason why the investor, whether he be possessed of one piece of property or more, should not come within the same rule.

The Government is safeguarded, since a marking down of book values in one year will necessarily result in a corresponding increase in future years or when the property is sold, if at the close of the particular transaction there should be a gain.

On the other hand, to wait until the transaction is closed for a final accounting burdens the investor with a heavy tax for the year in which the property is sold, adds to his inconvenience in making returns and results only in a rough approximation of the amount of tax actually due to the Government. To one who deals in any species of property constantly, it is difficult to compute with any degree of accuracy the

original cost of each item sold and the proportion of carrying charges charged to it. It is all the more difficult when the property was purchased many years before the incidence of the tax or when the part sold is only a small part of the original purchase.

Real estate purchased in large blocks and thereafter subdivided and sold in small parcels offers difficulties in determining the gain on any particular parcel in accordance with the present rulings of the Treasury Department, but can be determined with ease where it is based on an annual revaluation of the whole property.

Since the present method of computing gains on sale of capital assets results in annoyance to the taxpayer and Government officials alike and approaches the taxable gain only by mere approximation, while the inventory method is logical, convenient and fair, your Committee does not hesitate to urge that the law be so amended that inventory values may be taken, by those who keep books, as an annual measure of the gain or loss in the value of unsold assets and that returns of net income be accepted on that basis.

In order, however, to safeguard the interests of the treasury in case of reasonable doubt on the part of the authorities, as to the accuracy or good faith of the report, it may be just as well to guard against the possibility of abuse by some proviso. Your Committee would therefore recommend that:

"Taxpayers may be allowed reasonably to revalue their assets provided that in case of doubt the administrative authorities may ignore such revaluation and postpone the reckoning of profit or loss until it is actually realized by sale, complete obsolescence or some similar definite event."

XIV. Application for Refund of Income Taxes with Consequent Right of Appeal from the Decision of the Department Should be Allowed not only as at Present within Two Years from Date of Payment of the Tax but also, as a Matter of Course, at any Time, without Limit, as an Offset, where an Additional Tax for any Year is Claimed by the Government.

Section 3220 of the Revised Statutes now provides that the Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized, on appeal made to him, to remit, refund and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected.

Application for refund must be made within two years after the tax is paid. Real Estate Savings Bank *v.* The United States, 16 Ct. Cls., 335; 27 Int. Rev. Rec., 153; 104 U. S., 728; 28 Int. Rev. Rec., 27.

The Act permits assessment by summary proceedings upon the discovery of taxable income at any time within three years after the due date of the return in which such income should have been reported. It often happens that the inspectors of the Bureau of Internal Revenue postpone examination of the books of taxpayers until after two years have elapsed and at that time examine all returns which have been made since the previous examination. In such event, when the agent of the Government is so examining the records of the taxpayers for unreported income, the taxpayer also often finds instances which would lawfully entitle him to refund, but is precluded from applying therefore because of the expiration of the two-years' limit.

The appearance of the agent for the Government is a natural opportunity for the taxpayer to re-examine his own records in the light of new court decisions and new departmental rulings. The Committee believes it only just that he should at that time be enabled to assert his right to refund of excessive taxes paid within a period corresponding to that for which additional taxes may be claimed by the Government.

XV. The Permission now Granted to Officials of States Levying an Income Tax to Inspect the Returns of Corporations Should be Extended to the Returns of Individuals.

The so-called LaFollette amendment, which was incorporated into the present law, provides in substance that in those states which levy an income tax, authority is granted to the state officials to inspect the returns made by corporations. The object of this provision was clearly to afford a control of the returns made by such corporations for the purposes of a state income tax. If, as now seems not unlikely, an income tax should be introduced in other states, your Committee cannot see any good reason why the returns made by individuals to the Federal government should not likewise be open, under pledge of secrecy, to the officials levying the state income tax. This control would very greatly facilitate the administration of an income tax by state officials.

XVI. The Act Should Define Some, at Least, of the Special Terms therein Contained.

The act contains many terms of special significance, and occasionally use is made of the same term to express different meanings. The result is to make confusion worse confounded. The law is sufficiently difficult to understand without the ambiguity of terms.

The act uses the word "deduction" in referring to (1) expenses and losses to be offset against receipts in arriving at net income, (2) income from national, state and municipal bonds which is exempt from the provisions of the act, (3) the specific exemption of $3,000 or $4,000 which is allowed to individuals, and (4) the amount to be withheld at the source. A consistent use of terms clearly defined is urged as a necessity to a clear understanding of the intent of Congress.

The Committee does not deem it within its province to formulate definitions of terms which are used or should be used in the Act but calls attention to the following words and phrases as stumbling-blocks to lawyer and layman alike, several of which have been the cause of rulings and reversals of

rulings by the Treasury Department and endless confusion in the making of returns:

"Income."
"Net income."
"Gross income."
"Exemption."
"Deduction."
"Accrued."
"Accrual."
"Arising or accruing."
"Annuities."
"Within the year."
"Fixed or certain."
"Indefinite or irregular as to amount or time of accrual."
"Sustained."
"Agent." (As used in Paragraph D.)
"Accrued and paid within the year."
"Paid within the year."

(The last two phrases apply to interest deductions by corporations and individuals, respectively.)

Many other phrases could be enumerated. The theory that the law needs definitions to make it clear covers also such terms as "depreciation", "losses", "taxes", and "interest" (with particular reference to what constitutes interest and when it is paid in the discounting of notes, the purchase and sale of bonds with accrued interest, *etc.*). The task of formulating definitions is so great and in its nature so closely related to a general recasting of the language of the law that your Committee recommends that Congress appoint a commission of experts to devise some standard of terminology for the act.

Your Committee would, however, not press this matter too far. We recognize that in certain cases a hard and fast definition of some terms might do more harm than good. And we are convinced of the fact that in respect to some other terms, we are not yet prepared to make a satisfactory definition, and that in such cases the real meaning should grow under thoughtful, equitable interpretation by the administrative authorities and the courts. In this connection, however, your

Committee would most strongly repeat the recommendation that was made at the outset, for a complete restatement and clarification of the law.

XVII. Provision Should be Made for a More Elaborate Publication and Analysis of Income Tax Statistics.

It has been a serious disappointment to all students of general economic conditions in the United States that the statistics relative to the income tax published by the Government have been so meagre. In all other countries possessing an income tax full information is given, and valuable inferences are drawn from these statistics, not only by the fiscal authorities themselves but by students and business men. The statistics of the income tax ought to be in charge of a special department and ought to be presented in such a way as to furnish full information as to classification by the amount of income; the relation of income to occupation; the amount of exemptions; the amounts of deductions for expenses, interest on debt, taxes, losses, bad debts, depreciation, dividends, *etc.*; the amount of taxes paid by cities, especially where the cities comprise more than one collection district; the cost of collection in detail, *etc., etc.* The statistics published by the English and the Prussian income-tax officials furnish an admirable model of what ought to be attempted in the United States. Such statistics would not only be of the greatest possible service to the public at large, but would be found to be invaluable in the work of revising and perfecting the law itself. Your Committee earnestly recommends that the administrative authorities be empowered and directed to publish such full statistics.

Having completed our specific recommendations, we now proceed in a few concluding remarks to present some of the general considerations referred to at the beginning of this Report.

General Considerations.

There are at least four general matters of considerable difficulty in the elaboration of any income-tax law. On each of these points there is a wide difference of practice in the various countries; and on some of them there is by no means a complete unanimity among students of the subject. These four problems are: the general doctrine of income, the double taxation of income, the differentiation of the income tax, and the taxation of corporate income.

I. *The general doctrine of income.* Although the man in the street uses the term very glibly, the precise meaning of income is still in dispute. There are at least three different concepts of income recognized in important ways, with corresponding variations in the provisions of the income tax laws. One of the chief difficulties is to determine the exact relation of income to capital. Is everything that comes in during the year to be considered income, or are certain items to be regarded as accretions to capital; and *vice versâ,* are certain losses to be deducted from gross income or are they to be considered impairments of capital?

A satisfactory treatment of this topic would require much space; and would involve an investigation of such subjects as depreciation, obsolescence, depletion of natural resources, the temporary or permanent character of gains and losses and the like. While such a study would manifestly be out of place here, we have had occasion in our specific recommendations to call attention to certain glaring departures in the present law from the more obvious and generally recognized distinctions between income and capital.

Another question in the theory of income is whether it is to be limited to money or should include what the economists call use or service income, whether measurable in money or not.

The chief practical problem here arises in connection with the inclusion of the rental value of a house occupied by the owner. A has invested $100,000 in a house in which he lives; B has invested a similar amount in 5 per cent bonds, and lives in a rented house. If the rental value of A's house is not included in his income, he pays nothing; while B pays

tax on $5,000. Obviously, in order to put them on a strict equality, income should include rental value or money's worth as well as actual money received as income. The same arguments would apply to that part of a farmer's income which consists of the produce consumed by him. Yet, if we depart from the conception of money income, the question arises, where shall we stop? Shall we include the rental value of an automobile, of a library, of a picture gallery, of a yacht?

Although the income-tax laws of the Civil War period pursued at first a somewhat different policy, the present Act does not include any rental value, whether of real estate or of other things. In this respect, it is in harmony with some of the foreign laws.

Again, theories of income differ according as they include or exclude the idea of regularity of return. If only that income which is regularly received is to be considered as such, gifts, inheritances and sporadic or occasional and irregular earnings must be excluded. As a matter of fact, few income tax laws include gifts and inheritances in income; and the federal law here follows the practice of the majority with respect to individual incomes, thus seeming to lean to the conception of regularity or annual recurrency.

A further step in the direction of regularity would be to take the average income for a term of years instead of the income for a single year. Here, however, in contradistinction from many of the European laws, the present Act prefers the yearly income and does not permit of the three-year or five-year average.

II. The second general question is that of *the double taxation of income* or, at all events, that phase of the problem which consists of the simultaneous taxation of the same income by different jurisdictions. Practically, the question is as to the taxation of income earned in this country by persons living abroad, whether aliens or citizens; and, conversely, of incomes earned abroad, but received by residents of this country.

The general principles involved are in theory simple. Every government undoubtedly has a right to tax incomes earned

within the country, in so far as the income is derived from property situated therein. A strong argument may even be advanced for a similar treatment of incomes earned within a country, even if they are not derived from property. On the other hand, it is obvious that a foreigner owes some fiscal obligations to the country of his residence, even though his income is received in the country to which he belongs or where he has some property or business. It is clear, however, that the above principles are mutually exclusive; for if every country were to adopt both principles, many an individual would be taxed on his entire income simultaneously by two or more countries, *i. e.*, the country where he lives, the country to which he belongs and the country or countries in which he owns property or carries on a business.

There are two ways out of the difficulty. One is for each country to exempt certain categories of income. The trouble with this method is that the exemptions granted by different countries may either overlap or be inadequate, so that the individual will be taxed either too little or too much. The other solution consists of a mutual arrangement among the various countries which levy an income tax, with the result that each individual will be taxed upon his entire income only once, each country taking a certain share of the tax.

International comity has unfortunately not proceeded very far along this line. Such arrangements exist only between Germany and Austria and between Great Britain and some of her colonies, although there are similar arrangements among various European states affecting the inheritance tax. The United States has made no effort to enter on this path and has contented itself with very inadequate and lame provisions. According to our law, the income of all residents of the United States is taxable, irrespective of the fact whether that same income is taxed abroad. Furthermore, the law taxes all incomes received or earned within the United States, whether or not the individual resides here. It is to be recalled, however, that one notable exception exists; the foreign holders of the bonds of American corporations are not taxable on the interest therefrom.

The object of this exception was probably to favor the in-

vestment of capital in American enterprises by foreigners; just as England in her recent war loans is endeavoring to secure a better market in this country by exempting the holders of Government bonds from her income tax. It is to be observed, however, that according to our practice foreign stockholders are not exempt, at all events as far as the normal tax is concerned, since the corporation pays the tax irrespective of the nationality of its stockholders. On the other hand, it is to be noticed that we exempt foreign bondholders without inquiring whether or not they are taxed on this income by the country of their residence. Finally it must be mentioned that American citizens residing abroad are according to our law taxable on their entire income, irrespective of whether this income is also taxable in whole or in part by the country where they live. Under our present law, therefore, we have ample opportunity for the double taxation of certain persons and for the non-taxation of others. The situation is clearly unsatisfactory.

III. The third subject of controversy is that of *the differentiation of the income tax.* We have introduced into our law the policy of graduation, that is, taxing different amounts of income at different rates. But we have not adopted the plan of taxing different kinds of income at different rates. The distinction in question here is the one usually designated as that between funded and unfunded incomes, or between property and labor (or service) incomes. England, for instance, distinguishes between earned and unearned incomes; Italy between property incomes, business incomes and pure labor incomes.

Your Committee recognizes that it may be claimed that funded or unearned incomes should be taxed at a higher rate than unfunded or earned incomes; but in this country the question is complicated by the heavy taxes imposed by our state and local governments. The question of differentiation must therefore be considered not with reference merely to Federal taxation, but with reference to our entire system of Federal, state, and local taxation. And when so considered, it is quite possible that by the operation of state and local property taxes, a sufficient discrimination may already be made between funded and unfunded incomes.

We regard it as a fortunate circumstance that the existence of the state and local taxes may thus relieve the Federal government from the necessity of differentiating between different kinds of income. Such differentiation greatly complicates the structure of any income tax, and increases the difficulties of administration. If incomes are divided into only two classes, funded and unfunded, an arbitrary distinction usually has to be made between incomes derived by an individual or partnership from the conduct of a business enterprise and the dividends received by stockholders and bond holders in a corporate enterprise engaged in the same line of business. If, to avoid such difficulties in classifying income as funded or unfunded, the law undertakes to recognize three classes of incomes, funded, unfunded, and mixed—the structure of the law becomes extremely complicated, and great difficulties in administration are encountered. As long, therefore, as our commonwealths continue to derive their chief revenue from property taxes, it seems unnecessary to differentiate the rates of taxation imposed by the Federal government upon different kinds of income.

IV. The last of the general problems is that of *the taxation of corporate incomes*. It is illustrated by a difficulty connected with the limitation upon interest deductions in the present law. The amount of interest paid by a corporation on its indebtedness which may be deducted under the third of the enumerated deductions is subject to an arbitrary limitation. This raises the general problem involved in the taxation of corporate incomes. Here at least two points of view are possible. On the one hand, the object of an income tax may be declared to be to tax all incomes in the hands of the ultimate recipients. All income is ultimately received by individuals, and if every individual is taxed upon his entire income, the result will be that all incomes will be reached. From this point of view, any attempt to levy a tax on corporate incomes would be incorrect, for it would result either in the same income being taxed twice, once in the hands of the corporation and again in the hand of the ultimate recipient, or it would be necessary to introduce some elaborate system of partial exemptions, which would not be likely to work out satisfactorily.

Another possible point of view is that the income tax may be regarded to a certain extent also as a business tax, in so far, at all events, as the income is derived from business. Since most corporations are engaged in business they may therefore be said to be liable to such a business tax. Those holding the second view would contend that it is proper for the corporations to pay a tax on their entire income even though the security holders also pay a tax on their entire incomes. And, regardless of these two views, it may be claimed that to exempt corporations entirely from any such taxation would be injudicious from the point of view of fiscal results.

The practice of various countries is not in absolute accord with either of these views. Most income tax laws more or less illogically accept a portion of each as a compromise. No country exempts corporations entirely. No country taxes both the corporation and the security holder on the entire income. In our law, also, we find a compromise.

Your Committee presents these opposing views without attempting in this Report to decide their relative merits, leaving for future discussion the solution of this important problem. As this involves the question of the limitation upon interest deduction, we likewise refrain from present recommendation of change in this respect.

From this survey it will be seen how significant and how difficult are some of the still unsolved problems in the theory and the practice of the income tax. Your Committee desires simply to call attention to these general problems in the hope that they will be carefully considered when the time comes for a comprehensive reform of the law.

Respectfully submitted,

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